

Internal Revenue Service

Number: **201115006**

Release Date: 4/15/2011

Index Number: 355.01-01

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:6

PLR-128606-10

Date:

January 04, 2011

Legend

Distributing =

Controlled =

Company =

Shareholder a =

Shareholder b =

Shareholder c =

Shareholder d =

Shareholder e =

Shareholder f =

Shareholder g =

Shareholder x =

Shareholder y =

Shareholder z =

Business A =

State X =

Country Z =

Date 1 =

a =

b =

c =

d =

e =

f =

g =

h =

Dear :

This letter responds to your July 7, 2010 request for rulings on certain federal income tax consequences of the Proposed Transaction (defined below). The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Distribution (defined below): (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is being used principally as a device for the distribution of the earnings and profits of either Distributing or Controlled or both (see §

355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled (see § 355(e) and § 1.355-7).

Summary of Facts

Distributing is a closely-held State X corporation that was incorporated on Date 1. Distributing has always been treated as a subchapter S corporation. Distributing has two classes of stock outstanding, Class A common stock and Class B common stock. Class A and Class B have equal rights to operating and liquidating distributions, and differ only with respect to vote. Class A carries a vote per share. Class B is non-voting. Distributing has b shares of Class A stock and b shares of Class B stock outstanding, each of which is equally owned by the Family A Shareholders and the Family B Shareholders. The Family A Shareholders consist of Shareholder a, Shareholder b, Shareholder c, Shareholder d, and Shareholder e. The Family B Shareholders consist of Shareholder x, Shareholder y, and Shareholder z.

Distributing is engaged in Business A in the United States (the “U.S. Business”). Distributing owns all of the stock of Controlled, a State X corporation for which an election has been made to treat it as a qualified subchapter S subsidiary (“QSub”) for federal income tax purposes. Controlled owns a c% interest in Company, a Country Z entity that is treated as a partnership for U.S. federal income tax purposes. Company is also engaged in Business A (the “Country Z Business”). Distributing has submitted financial information indicating that the U.S. Business and the Country Z Business has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Significant disagreements have developed between the Family A Shareholders and the Family B Shareholders concerning the operation of Distributing. These disagreements have resulted in an inability to carry on the business effectively and potential litigation. Accordingly, Distributing has structured the Proposed Transaction, described below.

Proposed Transaction

For what is represented to be a valid business purpose, Distributing has proposed the following transaction (the “Proposed Transaction”):

(i) Distributing will distribute all of the Controlled stock to Shareholder x and Shareholder y in exchange for a portion of their Distributing stock of equal value, constituting d shares of their Class A stock and d shares of their Class B stock (the “Distribution”).

(ii) Pursuant to § 1.1361-5(b)(1)(i), the Distribution will cause a termination of Controlled's election to be treated as a QSub with the effect that Controlled will be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from Distributing in exchange for Controlled stock (the "Contribution"). The Contribution will be deemed to occur immediately before the Distribution.

(iii) Shareholder z will sell his e shares of Class A and f shares of Class B Distributing stock to the Family A Shareholders. Shareholder x and Shareholder y will sell their remaining g shares of Class A and h shares of Class B Distributing stock to the Family A Shareholders, Shareholder f and Shareholder g.

Following the Proposed Transaction, the Family A Shareholders, Shareholder f, and Shareholder g will own all of Distributing. Shareholder x and Shareholder y will own all of Controlled, which will elect to be treated as a subchapter S corporation. Shareholder z will no longer own an interest in Distributing or Controlled.

Representations

The following representations are made with regard to the Proposed Transaction:

(a) The indebtedness, if any, owed by Controlled to Distributing after the Distribution will not constitute stock or securities.

(b) The fair market value of the Controlled stock and other consideration to be received by Shareholder x and Shareholder y will be approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.

(c) No part of the consideration to be distributed by Distributing in the Distribution will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(d) The five years of financial information submitted for the U.S. Business conducted by Distributing is representative of the business's present operation, and with regard to this business, there have been no substantial operational changes since the date of the last financial statements submitted.

(e) The five years of financial information submitted for the Country Z Business conducted by Company is representative of the business's present operation, and with regard to this business, there have been no substantial operational changes since the date of the last financial statements submitted.

(f) Neither the U.S. Business nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a

transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing will have been the principal owner of the goodwill and significant assets of the U.S. Business and will continue to be the principal owner following the Distribution.

(g) Neither the Country Z Business nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Company will have been the principal owner of the goodwill and significant assets of the Country Z Business and will continue to be the principal owner following the Distribution.

(h) Following the Distribution, Distributing and Company (the partnership through which Controlled will be treated as conducting the Country Z Business) will each continue the active conduct of its business, independently and with its separate employees.

(i) The Distribution is being carried out for the following corporate business purpose: to separate ownership of Distributing between the Family A Shareholders and the Family B Shareholders so that business can be carried on without conflict. The Distribution is motivated, in whole or substantial part, by this corporate business purpose.

(j) The Distribution is not being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

(k) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(l) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that either: (i) was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution; or (ii) is received in the Distribution to the extent attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(m) The total adjusted basis of the assets Distributing will transfer to Controlled in the Contribution will equal or exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in the Contribution; and (ii) the amount of any cash and the fair market value of any other property (within the meaning of § 361(b)) received by Distributing from Controlled in the Contribution and transferred to the creditors of Distributing pursuant to the plan of reorganization.

(n) The liabilities assumed (within the meaning of § 357(d)) by Controlled in the Contribution and the liabilities to which the transferred assets are subject will have been incurred in the ordinary course of business and will be associated with the assets being transferred.

(o) The total fair market value of the assets Distributing will transfer to Controlled in the Contribution will exceed the sum of: (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in the Contribution; (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the Contribution; and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing from Controlled in the Contribution. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.

(p) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.

(q) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.

(r) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(s) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(t) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

(u) Immediately after the transaction (as defined in § 355(g)(4)), either: (i) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)); or (2) no person will hold a 50-percent or greater interest

(within the meaning of § 355(g)(3)) in any disqualified investment corporation (within the meaning of § 355(g)(2)), who did not hold such an interest in such corporation immediately before the transaction (as defined in § 355(g)(4)).

(v) Distributing is an S corporation within the meaning of § 1361(a). Immediately following the Proposed Transaction, Controlled will be eligible to elect S corporation status, and Controlled will elect to be an S corporation pursuant to § 1362(a). There is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

Rulings

Based solely on the information submitted and representations made, we rule as follows with regard to the Proposed Transaction:

- (1) The Contribution followed by the Distribution will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be a “party to a reorganization” within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution. §§ 361(a) and 357(a).
- (3) No gain or loss will be recognized by Controlled on the Contribution. § 1032(a).
- (4) The basis of each asset received by Controlled in the Contribution will equal Distributing’s basis in that asset immediately before the Contribution. § 362(b).
- (5) The holding period of each asset received by Controlled in the Contribution will include the period Distributing held that asset. § 1223(2).
- (6) No gain or loss will be recognized by Distributing on the Distribution. § 361(c)(1).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder x and Shareholder y on the receipt of Controlled stock in the Distribution. § 355(a)(1).
- (8) The aggregate basis of the Controlled stock received by Shareholder x and Shareholder y in the Distribution will equal the shareholder’s aggregate basis in the Distributing stock surrendered in exchange therefor, allocated in the manner described in § 1.358-2(a)(2). § 358(a)(1) and (b).
- (9) The holding period of the Controlled stock received by Shareholder x and Shareholder y in the Distribution will include the period the shareholder held the Distributing stock on which the Distribution is made, provided the shareholder held that

stock as a capital asset on the date of the Distribution. § 1223(1).

(10) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to make a subchapter S election under § 1362(a) for its first taxable year, provided such election is made effective immediately following the termination of the original QSub election.

Caveats

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, we express no opinion regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is being used principally as a device for the distribution of the earnings and profits of either Distributing or Controlled or both (see § 355(a)(1)(B) and § 1.355-2(d)); and (iii) whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled (see § 355(e) and § 1.355-7). In addition, we express no opinion concerning the tax consequences of step (iii) of the Proposed Transaction.

Procedural Statements

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this ruling letter.

In accordance with the power of attorney on file in this office, a copy of this ruling letter is being sent to your authorized representative.

Sincerely,

Richard M. Heinecke
Assistant to the Branch Chief, Branch 6
Office of Associate Chief Counsel (Corporate)